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Supreme Court, U.S.
FILED

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No. _____ OFFICE OF THE CLERK

In The
Supreme Court of the United States
October Term, 1996

CHANCE MANAGEMENT, INC., a South Dakota corporation, and WILLIAM A. SANDERS, a Wyoming resident,

Petitioners,

v.

STATE OF SOUTH DAKOTA, et al,

Respondents.

On Petition for Writ of Certiorari
To the United States Court of Appeals
For the Eighth Circuit

PETITION FOR WRIT OF CERTIORARI

STEVEN W. SANFORD
Counsel of Record
CADWELL SANFORD
DEIBERT & GARRY LLP
Attorneys for Petitioners
120 N. Phillips Avenue
Sioux Falls, SD 57104
(605) 336-0828

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86 pp

QUESTIONS PRESENTED

1. Is a discriminatory residency requirement saved by the market participation exception to Commerce Clause scrutiny where the State has a monopoly in the relevant market, governs the relevant market by comprehensive statutes and regulations, requires licenses of all participants and does not act as a buyer, seller or employer?

2. Does a nonresident shareholder whose corporation is denied a government license because of his nonresident status have standing to challenge the discrimination under the Privileges and Immunity Clause in Article II, §2 of the United States Constitution?

LIST OF PARTIES

The parties to the proceedings are:

Petitioners: Chance Management, Inc., a South Dakota corporation, and William A. Sanders, a Wyoming resident.

Respondents: State of South Dakota; Mark W. Barnett, in his official capacity as Attorney General of South Dakota; The South Dakota Lottery; Susan Walker, in her official capacity as Executive Director of the South Dakota Lottery; and H.I. King, Beverly McCracken, Elaine Emery, Don Bender, Burdette Solum and John E. Carmody, Sr., in their official capacities as members of the South Dakota Lottery Commission.

Note: Chance Management, Inc. has no subsidiaries or parent companies.

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OPINIONS BELOW

The District Court granted Respondents' motion for summary judgment and dismissed this action in a written opinion found at 871 F. Supp. 209 (Appendix B). The United States Court of Appeals for the Eighth Circuit affirmed the District Court in opinion found at 97 F.3d 1107 (Appendix A). Both opinions upheld, against Plaintiffs' federal constitutional challenges, a South Dakota statute barring nonresidents from holding a majority interest in any corporation owning video lottery machines in a state-owned video lottery. Where either opinion is cited, the applicable Appendix page is indicated in brackets.

STATEMENT OF JURISDICTION

Since Plaintiff commenced this action in the District Court to challenge South Dakota's video lottery residency requirement on federal constitutional grounds, jurisdiction of the District Court was based on 28 U.S.C. § 1331. A judgment dismissing the action was entered by the District Court on February 21, 1995. Notice of appeal was filed with the United States Court of Appeals for the Eighth Circuit on March 13, 1995, within 30 days of the entry of the Judgment of Dismissal, as required by Federal Rules of Appellate Procedure §4(a)(1).

Judgment of the United States Court of Appeals for the Eighth Circuit was entered on October 10, 1996. This Petition for Writ of Certiorari is timely filed within 90 days of the Court of Appeals' Judgment.

The Court's jurisdiction to review the Order of the United States Court of Appeals for the Eighth Circuit affirming the District Court's grant of summary judgment is invoked pursuant to 28 U.S.C. §1254(1).

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED IN THIS CASE

Article I, §8 of the United States Constitution provides in relevant part:

> The Congress shall have the Power . . . [t]o regulate Commerce . . . among the several States . . . .

Article IV, §2 of the United States Constitution provides:

> Citizens of each State shall be entitled to all Privileges and Immunities of Citizens in the Several States.

Article III, §25 of the South Dakota Constitution provided in relevant part as of 1993:

> The Legislature shall not authorize any game of chance [or] lottery . . . . However, it shall be lawful for the Legislature to authorize by law, a state lottery which is regulated, controlled, owned and operated by the State of South Dakota, either separately by the State or jointly or in cooperation with one or more states. The entire net proceeds of such lottery shall be de-

> voted to the operation of state government or for such other purpose as the Legislature shall determine.

The South Dakota Lottery was created and is governed by Chapter 42-7A of the South Dakota Codified Laws ("SDCL"). Those 65 statutes and over 80 regulations for video lottery, found at Administrative Rules of South Dakota ("ARSD") §§ 48:2:1-48:2:13 are too voluminous to set out verbatim here. Cited statutes and regulations are reproduced in Appendix C.

SDCL 42-7A-43 provides in relevant part (emphasis supplied):

> A video lottery machine manufacturer or distributor shall meet the same requirements of subdivisions 42-7A-13(1)-(4) and §42-7A-14. A video lottery machine operator shall meet the same requirements of §§ 42-7A-13 and 42-7A-14, *in addition to being a resident of the State of South Dakota and, if a partnership or corporation, the majority of ownership interest shall be held by residents of the State.* A lottery retailer shall meet the same requirements of §§ 42-7A-13 and 42-7A-14.

STATEMENT OF THE CASE

A. Jurisdiction of the District Court

Plaintiff brought this action to challenge on federal constitutional grounds the residency requirement imposed in SDCL 42-7A-43 for video lottery machine operators. Jurisdiction was premised on 28 U.S.C. § 1331.

B. Statement of Facts

Petitioner Chance Management, Inc. ("Chance") is a South Dakota corporation. Petitioner William A. Sanders ("Sanders") is a Wyoming resident and owns a majority interest in Chance. In 1989, the South Dakota constitutional prohibition against gambling was amended to permit a State-owned lottery as a means of funding State government. South Dakota Constitution, Article III, §25.[1] Pursuant to that Constitutional provision, the South Dakota Legislature created an independent state agency called the South Dakota Lottery under direction of the South Dakota Lottery Commission (the "Lottery Commission"). SDCL 42-7A-2. The Lottery Commission was directed to operate a video lottery. SDCL 42-7A-4(11A). Video lottery is implemented by placing video lottery machines in licensed establishments in South Dakota, namely restaurants, bars, lounges or lodging establishments licensed to sell alcoholic beverag-

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[1] This section was clarified by amendment in 1994 expressly to permit video lottery in response to a decision of the South Dakota Supreme Court. See *Poppen v. Walker*, 520 N.W.2d 238 (S.D. 1994).

es on the premises. SDCL 42-7A-1(6); 42-7A-37; 42-7A-37.1.

Through the use of outside consultants, the Lottery Commission developed computer programs for the operation of video lottery and also acquired a central computer and related hardware and software. The manufacture, distribution, ownership, placement and maintenance of video lottery machines was all accomplished by private persons and firms.

Every private person or firm in any way connected with video lottery must obtain a license. SDCL 42-7A-41. The various licensees are video lottery machine manufacturers, video lottery machine distributors, video lottery machine operators ["Operator(s)"] and video lottery establishments. An Operator purchases video lottery machines and places them in video lottery establishments. Operators are required to service in-place machines and are responsible for paying the State's share of the net revenue to each machine. The South Dakota Lottery determines the State's share through a computer link with each machine and electronically debits the Operator's bank account for that share.

Originally the State's share of net revenue was 35%. ARSD 48:02:06:02. The South Dakota Legislature increased the State's share in 1995 to 50%. SDCL 42-7A-63.

A nonresident cannot obtain an Operator's license. A partnership or corporation applying for an Operator's license must have a majority ownership by

South Dakota residents. No such residency requirement is imposed upon persons, partnerships or corporations applying for licenses as manufacturers, distributors or establishments. SDCL 42-7A-43.

Chance applied for an Operator's license. As a part of its application, Chance included individual histories from Sanders and the resident minority owner ("Johnson"). The background investigations of Sanders and Johnson were the same even though Sanders was a nonresident and Johnson was a resident. Eventually the application was denied solely because Sanders was a nonresident majority owner of Chance.

The Lottery Commission has licensed over 100 Operators. No application for an Operator's license was ever denied until Chance's application was denied because of Sanders' residency in Wyoming.

C. Decision by the Court of Appeals

The United States Court of Appeals for the Eighth Circuit held that: The residency requirement was immune from Commerce Clause scrutiny because South Dakota was a market participant in the monopoly market it had created [17a]; and Sanders did not have standing to challenge the statutory discrimination against him under the Privileges and Immunities Clause [21a].[2]

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[2] The Court of Appeals also rejected Petitioners' Equal Protection argument, which is not a subject of this Petition.

REASONS FOR GRANTING THE WRIT

SUMMARY

The Court of Appeals has extended the market participation exception beyond the private market contexts that gave rise to this Court's recognition of the doctrine. Its decision conflicts with those of other Circuits. In instances where a State acts other than in its capacity as a buyer, seller or employer, the limits of the market participation exception are not clear.

There is a split in Circuits deciding the question whether a nonresident shareholder has standing to his nonresident status has been used to deny his corporation the right to a state-issued license or contract. The Court of Appeals' opinion is a recipe for a kind of state discrimination against nonresidents that jeopardizes our federal system and has long concerned this Court. The Court has never directly decided the issue, however.

1. A DISCRIMINATORY RESIDENCY REQUIREMENT IS NOT SAVED BY THE MARKET PARTICIPATION EXCEPTION TO COMMERCE CLAUSE SCRUTINY WHERE THE STATE HAS A MONOPOLY IN THE RELEVANT MARKET, GOVERNS THE RELEVANT MARKET BY COMPREHENSIVE STATUTES AND REGULATIONS, REQUIRES LICENSES OF ALL PARTICIPANTS AND DOES NOT ACT AS A BUYER, SELLER OR EMPLOYER.

Absent the shield of the market participation doctrine, South Dakota's discrimination in its video lottery system against nonresident Operator applicants

violates the Commerce Clause. It is just the sort of discrimination that time and again this Court has struck down. See e.g. *Wyoming v. Oklahoma*, 502 U.S. 437 (1992). Respondents have conceded as much. 97 F.3d at 1118 n.9 (Lay, J., dissenting) [29a].

The Court has held, however, that the purposes of the Commerce Clause are not implicated by a State's exercise of "the long recognized right of a trader or manufacturer, engaged in an entirely private business, freely to exercise his own independent discretion as to parties with whom he will deal." *Reeves, Inc. v. Stake*, 447 U.S. 429, 438-39 (1980). Thus, in *Reeves*, the State of South Dakota as the owner of a cement plant could prefer South Dakota residents in its sales of cement without running afoul of the Commerce Clause. The Court relied on *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794 (1976), which held that the State of Maryland had the right to enter into the market for scrap car bodies "to bid up their price . . . as a purchaser," favoring its own citizens, free of scrutiny under the Commerce Clause. 426 U.S. at 806, 808.

The last successful invocation of the market participation exception was in *White v. Massachusetts Council of Construction Employers, Inc.*, 460 U.S. 204 (1983). There an order of the City of Boston Mayor establishing a residency requirement for construction workers employed in projects funded in whole or in part by City funds was afforded the market participant immunity. The Court noted that "[e]veryone affected by the Order is, in substantial if informal sense, 'working for the city[,]'" and held that the City acts as a market

participant when "it expends only its own funds in entering into construction projects for public works." 460 U.S. at 211 n.7, 214-15.

South Dakota's discrimination against nonresidents in video lottery is qualitatively and quantitatively different from any State discriminatory market activity ever sanctioned by the Court. In particular:

- South Dakota has not entered a preexisting private market such as for scrap auto bodies, ready-mix cement or building construction.

- Instead, South Dakota created the market for video lottery and maintains it for the sole purpose of generating revenue to support government.

- South Dakota operates video lottery (the "market") as a monopoly through exercise of its sovereign power. For instance, instead of subjecting its share of net revenues to private market forces, it raises its share by legislative fiat. SDCL 42-7A-63.

- In the process of discriminating against nonresidents. South Dakota does not employ any Operators, buy anything from any Operators or sell anything to any Operators.

- In enforcing its statutory residency requirement, South Dakota acts as a regulator.

- South Dakota does not deal with Operators by contract, but instead by government license. Licensing is a primeval government activity and not insulated by the market participation exception.

- South Dakota does not expend any of its own funds in purchasing video lottery machines, servicing them, manufacturing, distributing or selling them and does not pay any Operator. Instead, it merely sweeps the Operator's account for half the take. ARSD 48:02:06:03.

The Commerce Clause jurisprudence in the 13 years since *White* has been characterized, except in the Eighth Circuit, by limitations on the market participation exception. Indeed, no discrimination against nonresidents otherwise violating the Commerce Clause has, since *White*, been given refuge by this Court through the market participation exception.

In *South-Central Timber Development, Inc. v. Wunnicke*, 467 U.S.C 82 (1984) the Court held that a state could not rely on the market participation exception to impose discriminations on nonresidents in markets in which they did not directly participate. Fatal to Alaska's argument was this Court's perception that Alaska was exercising powers beyond those of a normal seller in a commercial market. *Id.* at 96. In *Wisconsin Department of Industry, Labor and Human Relations v. Gould, Inc.*, 475 U.S. 282 (1986) the Court invalidated Wisconsin's attempts to prohibit state purchasers from repeat labor law violations because the state was func-

tioning as a regulator rather than as a private purchaser. *Id.* at 289. In *New Energy Company of Indiana v. Limbach*, 486 U.S. 469 (1988), a sales tax credit for the sales of Ohio-produced ethanol was struck down because the action "ultimately at issue is neither [Ohio's] purchase nor its sale of ethanol, but its assessment and computation of taxes–*a primeval governmental activity.*" *Id.* at 277 (emphasis supplied). Apparently critical to the Court's holding was the fact that the unconstitutional activity could not "plausibly be analogized to the activity of a private purchaser." *Id.* at 278. Finally, in *Wyoming v. Oklahoma*, 502 U.S. 437 (1992) a statute requiring all utilities to purchase Oklahoma-produced coal was struck down in its entirety, even though in some instances the state acted as a coal purchaser, i.e. market participant. *Id.* at 460-61.

The Courts of Appeals, other than the Eighth Circuit, have followed this Court's lead in allowing the market participation exception only where a state acts in ways analogous to a private competitor. See *Western Oil & Gas Association v. Corey*, 726 F.2d 1340 (9th Cir. 1984), *aff'd* 471 U.S. 81 (1985), *rehearing denied*, 471 U.S. 1112 (1985) (state acting in a sovereign capacity as landowner and holding a monopoly could not be a market participant); *Big Country Foods, Inc. v. Board of Education of Anchorage School District*, 952 F.2d 1173 (9th Cir. 1992) (state a market participant in buying milk for school use because it did not hold a monopoly in milk purchases); *Atlantic Coast Demolition & Recycling, Inc. v. Board of Chosen Freeholders of Atlanta County*, 48 F.3d 701 (3rd Cir. 1995) (state waste disposal districts

not entitled to market participation exception even though they engage in the private waste disposal market because the subject restrictions were imposed by the state as a regulator); *GSW, Inc. v. Long County, Georgia*, 999 F.2d 1508 (11th Cir. 1993) (market participation exception not applicable where the restriction is imposed by formal government action such as by resolution or statute); *SSC Corp. v. Town of Smithtown*, 66 F.2d 502 (2nd Cir. 1995) (city's waste disposal flow control regulations not market participation because they were so unlike what a private party could have done in the market and thus constituted regulation); *USA Recycling, Inc. v. Town of Babylon*, 66 F.3d 1272 (2nd Cir. 1995) (city as market participant not entitled to exception in instances where it acts as a regulator in denying licenses and imposing penalties on those who act without licenses).

In clothing South Dakota with the market participation exception despite its monopoly in video lottery, its regulation of the monopoly by 150 statutes and regulations and its use of the licensing as a primeval governmental activity, the Eighth Circuit Court of Appeals has strayed from the teachings of this Court and acted in conflict with the relevant decisions in other Circuits. The Court should grant this Petition to correct this misapplication of the market participation exception and to resolve the conflict among the Circuits.

2. A NONRESIDENT SHAREHOLDER WHOSE CORPORATION IS DENIED A GOVERNMENT LICENSE BECAUSE OF HIS NONRESIDENT STATUS HAS STANDING TO CHALLENGE THE DISCRIMINATION UNDER THE PRIVILEGES AND IMMUNITY CLAUSE IN ARTICLE II, §2 OF THE UNITED STATES CONSTITUTION.

The Court has held that "one of the privileges to which the [Privileges and Immunities] Clause guarantees to citizens of State A is that of doing business in State B on terms of substantial equality with citizens of that State." *Toomer v. Witsell*, 334 U.S. 385, 396 (1948). The residency requirement in SDCL 42-7A-43 violates Sanders rights under the Privileges and Immunities Clause. See *Barnard v. Thorstenn*, 489 U.S. 546 (1989). This is true even if the Commerce Clause is inapplicable because of the market participation exception. *United Building & Construction Traits Council of Camden County and Vicinity v. Mayor and Council of the City of Camden*, 465 U.S. 208, 219-20 (1984).

Neither the District Court nor the Court of Appeals reached this question. Instead, both held that Sanders did not have standing to challenge the video lottery residency requirement because Sanders was not the applicant denied a license; and thus he could not articulate a cognizable injury. 97 F.3d at 1115-16 [21a]; 871 F. Supp. at 213 [49a].

The question of shareholder standing was before the Court in *Franchise Tax Board of California v. Alcan Aluminum, Ltd.*, 493 U.S. 331 (1990). The Court held

that a Canadian parent corporation had Article III standing to challenge taxes assessed against its American subsidiaries, but did not reach the question whether the Canadian parent corporation could meet the prudential requirements of the standing doctrine. *Id.* at 336-37. The latter issue is squarely presented by this Petition.

In *Lujan v. Defenders of Wildlife*, 504 U.S. 555, 561 (1992), the Court observed:

> When the suit is one challenging the legality of government action or inaction, the nature and extent of the facts that must be averred (at the summary judgment stage) or proved (at the trial stage) in order to establish standing depends considerably on whether the plaintiff is himself an object of the action (or foregone action) at issue. If he is, there is ordinarily little question that the action or inaction has caused him injury, and that a judgment preventing or requiring action will address it.

As a Wyoming resident Sanders cannot obtain an Operator's license. He cannot do business as a corporation and obtain an Operator's license for that corporation. Sanders individually must meet all statutory and regulatory requirements, even though Chance is the applicant. ARSD 48:02:02:02. As the object and victim of the discrimination, Sanders indeed satisfies the *Lujan* standard.

A nonresident shareholder was held to have standing to challenge a state license residency requirement for a corporation's shareholders in *Cooper v. McBeath*, 11 F.3d 547, 551 (5th Cir. 1994). An individual shareholder was denied standing in *Smith Setzer & Sons Incorporated v. South Carolina Procurement Review Panel*, 20 F.3d 1311 (4th Cir. 1984), where the residency of the corporation was not in any way determined by the identity, location or other characteristics of its shareholders.

The Court of Appeals relied on *Smith Setzer & Sons, supra*, and rejected *Cooper, supra*, failing to focus on the distinction between the two cases. In *Cooper* it was the characteristic of the shareholder and not the corporation which gave rise to the injury; in *Smith Setzer & Son* the "harm" arose from the characteristics of the corporation, and not its shareholders.

The teaching of *Lujan, supra* suggests that the 8th Circuit Court of Appeals erred in relying on *Smith Setzer & Sons, supra*. At a minimum the petition should be granted to resolve conflicts between the Fourth and Fifth Circuits on this important question, which was raised in *Alcan Aluminum, supra* but not decided by the Court.

CONCLUSION

When South Dakota imposes a residency licensing requirement in the video lottery market it created and monopolizes, the State bears no resemblance to a private market participant. The decision of the Eighth Circuit Court of Appeals is contrary to the decisions of this Court and is in conflict with every relevant decision in every other Circuit.

The standing of a corporation's shareholder who is the object of licensing discrimination as a nonresident has not been fully decided by this Court. At least two Circuits are in conflict.

For all the above reasons, this Petition should be in all respects granted.

Respectfully submitted,

STEVEN W. SANFORD
Counsel of Record
CADWELL SANFORD
DEIBERT & GARRY LLP
Attorneys for Petitioners
120 N. Phillips Avenue
Sioux Falls, SD 57104
(605) 336-0828

DATED: December 19, 1996

APPENDIX A
Eighth Circuit Court of Appeals Opinion
Entered October 10, 1996

No. 95-1665

CHANCE MANAGEMENT, INC., a South Dakota corporation, and William A. Sanders, a Wyoming resident, Plaintiffs,
v.
STATE OF SOUTH DAKOTA; Mark W. Barnett in his official capacity as Attorney General of South Dakota; the South Dakota Lottery; Susan Walker, in her official capacity as Executive Director of the South Dakota Lottery; and H.I. King, Beverly McCracken, Elaine Emery, Don Bender, Burdette Solum, and John E. Carmody, Sr., in their official capacities as members of the South Dakota
Lottery Commission, Defendants.

Appeal from the United States District Court
for the District of South Dakota

Submitted: November 17, 1995

Filed: October 10, 1996

Before HANSEN, LAY, and MURPHY, Circuit Judges.

HANSEN, Circuit Judge.

A corporation may obtain a license as a video lottery machine operator for the South Dakota Lottery only if residents of South Dakota hold the majority ownership interest in the corporation. S.D. Codified Laws Ann. § 42-7A-43 (Supp. 1995). Chance Management, Inc., and William A. Sanders filed this suit, challenging the constitutionality of the residency requirement under the Commerce Clause, the Equal Protection Clause of the Fourteenth Amendment, and the Privileges and Immunities Clause. The district court[1] granted the defendants summary judgment. The court concluded that Commerce Clause restrictions do not apply to the statute because the state of South Dakota is acting as a market participant in the video lottery business. The court further held that the statute does not violate the Equal Protection Clause and that the plaintiffs have no standing to assert the Privileges and Immunities Clause challenge. The plaintiffs appeal. We affirm.

I.

In South Dakota, various forms of gambling are legal. See S.D. Codified Laws Ann. §§ 42-7-47 to -106 (1991 & Supp. 1996) (horse and dog racing); id. §§ 42-7A-1 to -55 (South Dakota Lottery); id. §§ 4242-7B-1 to -62 (card games and slot machines). South Dakota owns and operates one of the gaming enterprises in South Dakota, the South Dakota Lottery, which is a video

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[1]The Honorable John B. Jones, United States District Judge for the District of South Dakota.

lottery business. Video lottery consists of games of chance played on a computer-controlled video machine, simulating the games of poker, blackjack, keno, and bingo. South Dakota operates its video lottery business in accordance with Article III, Section 25 of the South Dakota Constitution, which, as amended in 1994,[2] reads as follows:

> The Legislature shall not authorize any game of . . . lottery . . . . However, it shall be lawful for the Legislature to authorize by law, a state lottery or video games of chance, or both, which are regulated by the state of South Dakota, either separately by the state or jointly with one or more states, and which are owned and operated by the state of South Dakota, either separately by the state or jointly with one or more states or persons, provided any such

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[2]The South Dakota Lottery began operating in October 1989. In 1994, the Supreme Court of South Dakota declared that the state was not actually running a lottery, but games of chance, in violation of the South Dakota Constitution. Poppen v. Walker, 520 N.W.2d 238 (S.D. 1994). The South Dakota Legislature responded by passing a joint resolution amending the South Dakota Constitution to allow the South Dakota Lottery. The voters of South Dakota approved the proposed constitutional amendment, and in November 1994, under the amended Article III, Section 25 of the South Dakota Constitution, video lottery operations again commenced.

> video games of chance shall not directly dispense coins or tokens.

Chapter 42-7A of the South Dakota Codified Laws establishes the state's video lottery under the direction of an independent state agency, the South Dakota Lottery Commission (the Commission). S.D. Codified Laws Ann. § 42-7A-2 (Supp. 1995). This chapter creates a detailed statutory scheme governing South Dakota's video lottery business. See id. § 42-7A-1 to -55. An executive director administers the lottery pursuant to the provisions of Chapter 42-7A, id. § 42-7A-2, and under the rules and regulations promulgated by the Commission, id. § 42-7A-21.

South Dakota controls and operates its video lottery business in large part through a central computer system, which is located in the main office of the South Dakota Lottery in Pierre, South Dakota. Although the state does not own the video machines on which the games of chance are played or the modems attached to the machines, it owns the dominant software programs that operate the machines. The state owns the Erasable, Programmable, Read Only Memory (EPROM) chips in the video machines, without which the machines could not function. The EPROM chips contain the data that protects and secures the system from invasion by outside influences. In the first year of its operation, the state spent two million dollars on the central computer system, personnel, and related expenses.

Video lottery machine operators (operators) own the individual video machines and are responsible for their operation and maintenance. (J.A. at 49.) An

operator places video lottery machines or associated equipment for authorized play in licensed video lottery establishments in South Dakota, including restaurants, bars, lounges, or lodging establishments licensed to sell alcoholic beverages on the premises. S.D. Codified Laws Ann. §§ 42-7A-1(6) (defining "licensed establishment"), -1(17) (defining "video lottery machine operator"). The state bills the operators for its portion of the revenue, receiving payment by electronically sweeping the operators' bank accounts. S.D. Admin. R. 48:02:06:03 (1992). The state's share of the net income was 37 per cent at the time the district court decided this case; the South Dakota Legislature has since increased the state's portion to 50 per cent.

All video lottery machine manufacturers, distributors, and operators must obtain a license from the executive director of the South Dakota Lottery in order to do business with the Lottery. S.D. Codified Laws Ann. § 42-7A-41. Before issuing a license to any of these parties, the state undertakes a background investigation to ascertain whether the applicant qualifies for a license. Id. §§ 42-7A-43 (investigation), -13 (qualifications), -14 (ineligible persons); see also S.D. Admin. R. 48:02:02:01 (additional qualification requirements for licensure). A corporate applicant cannot obtain a license until each person who has the ability to control the corporation's activities or to elect a majority of the corporation's board of directors has passed the requirements set out for individual applicants. S.D. Admin. R. 48:02:02:02.

In addition to passing the background investigation, a person must be a resident of South Dakota to

obtain a video lottery machine operator's license. S.D. Codified Laws Ann. § 42-7A-43. If the party seeking an operator's license is a corporation, a majority of the ownership interest in the corporation must be held by South Dakota residents in order to qualify for a license. Id.

Plaintiff Chance Management, Inc., is a corporation organized under the laws of the state of South Dakota and is owned by two persons. Plaintiff William A. Sanders, a resident of Wyoming, owns the majority (51%) of the stock in Chance Management, with the remaining shares (49%) owned by a South Dakota resident. Chance Management applied for a video lottery operator's license but was turned down because its majority shareholder failed to meet the residency requirement under § 42-7A-43.

Chance Management and Sanders filed this suit against the state of South Dakota, the executive director of the state lottery, and various members of the state Lottery Commission. Plaintiffs challenged the constitutionality of the residency requirement under the Commerce Clause, the Equal Protection Clause of the Fourteenth Amendment, and the Privileges and Immunities Clause. Both sides filed motions for summary judgment. The district court granted the defendants' motion, holding that the statute does not run afoul of either the Commerce Clause or the Equal Protection Clause. The court further held that the plaintiffs lacked standing to mount the Privileges and Immunities Clause challenge. See Chance Management, Inc. v. South Dakota, 876 F. Supp. 209, 211-13 (D.S.D. 1995). Chance Management and Sanders appeal.

II.

We review the district court's grant of summary judgment de novo. Independent Charities of Am., Inc. v. Minnesota, 82 F.3d 791, 795 (8th Cir. 1996). Summary judgment is appropriate when the evidence, viewed in the light most favorable to the nonmoving party, shows there is no genuine issue of material fact and the moving party is entitled to judgment as a matter of law. Id.; Cotto Waxo Co. v. Williams, 46 F.3d 790, 792 (8th Cir. 1995).

A. Commerce Clause Challenge

Under the Commerce Clause of the Constitution of the United States, "Congress shall have Power . . . To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes . . . ." U.S. Const. art. I, § 8, cl. 3. This clause acts not only as an affirmative grant of regulatory power to Congress, but also "as a restriction on permissible state regulation." Hughes v. Oklahoma, 441 U.S. 322, 326 (1979). "This 'negative' or 'dormant' aspect of the Commerce Clause prohibits economic protectionism – that is, regulatory measures designed to benefit in-state economic interests by burdening out-of-state competitors." Charities, 82 F.3d at 798 (citing New Energy Co. of Indiana v. Limbach, 486 U.S. 269, 273 (1988)).

Because the power granted to Congress under the Commerce Clause is the power to "regulate Commerce . . . among the several States," the correlative restrictions on the states under the Commerce Clause are invoked only when a state engages in regulation. Therefore, the

Supreme Court has drawn a distinction between state "regulation of" a market and state "participation in" a market. SSC Corp. v. Town of Smithtown, 66 F.3d 502, 510 (2d Cir. 1995), cert. denied, 116 S. Ct. 911 (1996). See South-Central Timber Dev., Inc. v. Wunnicke, 467 U.S. 82, 93-95 (1984) (plurality opinion); White v. Massachusetts Council of Constr. Employers, 460 U.S. 204, 208 (1983); Reeves, Inc. v. Stake, 447 U.S. 429, 436-37 (1980); Hughes v. Alexandria Scrap Corp., 426 U.S. 794, 808-10 (1976). A state acting as a market participant is free from the strictures of the Commerce Clause because "there is no indication that the [Commerce] Clause was intended to limit the ability of the [s]tates themselves to operate in the free market." Charities, 82 F.3d at 799. States acting in a proprietary capacity should be as free from federal constraints as are private market participants. Id.

We agree with the district court's conclusion that South Dakota's video lottery statute, including its residency requirement, falls within the market participant exception to the Commerce Clause. To begin with, the statute created a state business within the gaming market. South Dakota invested substantial sums of money to get the South Dakota Lottery off the ground. The state owns the dominant software programs that operate the video lottery machines and owns the computer system that controls the machine payouts. Moreover, the state presently reaps 50 percent of the revenue generated by the South Dakota Lottery. Thus, South Dakota is actively running a business in the gaming market. In furtherance of its money-making enterprise, the state has created a business relationship with its video lottery machine operators much akin to a partner-

ship or joint venture between private parties. Because South Dakota's choice of its "business partners" is made in its role as a market participant, its decision to deal only with corporations owned in major part by South Dakota residents is beyond the purview of the Commerce Clause. "[T]he [s]tate, like any private [gaming company], has a right to select the parties with whom it will deal." Id. The lure of the huge profits to be made in the gaming market proved too attractive for the legislature. Instead of just taxing or regulating the other participants in the market, the legislature opted instead to be the largest participant, to own and to operate a huge piece of the action. That it is the dominant actor in the market does not mean it is not a participant.

The plaintiffs argue that the state is not acting as a market participant because it is not acting as a buyer, seller, or employer. The plaintiffs base this argument on the roles the states played in the three Supreme Court cases applying market participant exception. See White, 460 U.S. at 205-06 (employer); Reeves, 447 U.S. at 432 (seller); and Alexandria Scrap, 426 U.S. at 799 (buyer). The reasoning of these cases, however, does not support the plaintiffs' argument. The Court's inquiry in the market participation cases asks not whether the state is acting as a buyer, seller, or employer when it participates in a market, but whether the state is actually participating in a narrowly defined market as a proprietor rather than simply regulating the actions of other private market participants. Wunnicke, 467 U.S. 94-95 (explaining White, Reeves, and Alexandria Scrap), 97-98 (explaining that a state must actually be participating in the specific market it is regulating for the market participation exception to apply) (plurality opinion). We do not

believe that it can seriously be questioned that South Dakota has invested substantial money and effort into participating in the narrowly defined gaming market as a proprietor.

The plaintiffs argue that the residency requirement is the functional equivalent of the statute the district court declared unconstitutional in Gulch Gaming, Inc. v. South Dakota, 781 F. Supp. 621 (D.S.D. 1991). The statute at issue in Gulch Gaming imposed a residency requirement on operators or retailers engaged in gaming in Deadwood, South Dakota. S.D. Codified Laws Ann. § 42-7B-25. Although the statute at issue in Gulch Gaming appears to be analogous to the one presently before us, the state's role in Gulch Gaming was entirely different from its role here. In Gulch Gaming, the state had no ownership interest in the gaming activity and was acting solely as a regulator of gambling conducted by private businesses in Deadwood. Here, however, the residency requirement reflects a decision by the state taken as an owner and operator of the gaming business.

The plaintiffs also contend that the residency requirement falls outside the market participation exception because the residency requirement is unrelated to the state's participation in a private market. Plaintiffs point to the fact that the state imposes a number of requirements on video lottery machine manufacturers and restricts the manufacturers' sales of the machines to licensed distributors and operators. Plaintiffs argue that under Wunnicke, this restriction violates the Commerce Clause.

Wunnicke involved a Commerce Clause based constitutional challenge to a requirement that timber harvested from Alaska state-owned lands be processed in Alaska prior to export. 467 U.S. 84-86. In its market participant discussion, the Court first defined the relevant market, concluding that Alaska was a market participant in the timber industry as a seller of timber, but was not a market participant in the timber processing industry. Id. at 98. A plurality of the Court concluded that requiring private parties who purchased timber from the state of Alaska to process their timber in Alaska was a downstream regulation outside of the relevant market in which Alaska was participating and therefore not within the bounds of the market participation exception. Id. at 99. The Court explained:

> The limit of the market-participant doctrine must be that it allows a State to impose burdens on commerce within the market in which it is a participant, but allows it to go no further. The State may not impose conditions, whether by statute, regulation, or contract, that have a substantial regulatory effect outside of that particular market. Unless the "market" is relatively narrowly defined, the doctrine has the potential of swallowing up the rule that States may not impose substantial burdens on interstate commerce even if they act with the permissible state purpose of fostering local industry.

Id. at 97-98.

This language indicates that the market participant exception is limited to the actual market in which the state is participating, and to that extent, the plaintiffs' assertion that the statute must be related to the state's participation is correct. Once we determine that the state is participating in the relevant market, however, we do not scrutinize, under Commerce Clause analysis, whether the state's proprietary decisions best meet the state's goals. We further note that unlike Alaska in Wunnicke, South Dakota is actually participating in the market affected by the legislation at issue in this case. Moreover, the residency requirement for video lottery machine operators does not reach beyond those parties who are actually and freely dealing with the state in its business enterprise.

The plaintiffs rely on GSW, Inc. v. Long County, 999 F.3d 1508 (11th Cir. 1993), to support a broader interpretation of the import of Wunnicke. In GSW, the Eleventh Circuit held that the county was not a market participant where a county resolution geographically limited the sources of the solid waste that a local private waste disposal facility could take. The facts of GSW are fundamentally different from those before us today, because the county had no investment in the market in which it asserted it was participating and had even made sure it would not be subject to any liability. By contrast, South Dakota has put substantial sums of money at risk in entering the gaming market. Furthermore, our analysis is simply not altered by the court's language that, under Wunnicke, "courts will scrutinize 'the relationship of the subject matter of the contract [or legislation] and the condition imposed.'" GSW, 999 F.2d

at 1516 (citation omitted). Rather, that is precisely what we have done.

Our analysis is consistent with the Supreme Court's decision in Wyoming v. Oklahoma, 502 U.S. 437, 461 (1992). In that case, Oklahoma argued that it was acting as a market participant because it owned a utility. Notwithstanding Oklahoma's participation in the market, the Court held that Oklahoma could not require private utility companies to purchase a certain percentage of coal from Oklahoma sources. The Court distinguished between a state's imposition of limitations on its own utility business and the regulation of private companies, noting that the statute "would become a fundamentally different piece of legislation were it construed to apply only to the [state-owned utility company]." Id. at 461. If the case before us today involved a residency requirement for corporations doing business with private gaming companies in which the state had no proprietary interest, this case would be like Wyoming v. Colorado.[3] However, we are considering "a fundamentally different piece of legislation"; the statute at issue in this case "applies only to the [state-owned gaming company]." Id. As such, the state's residency requirement falls within the market participation exception to the Commerce Clause.

The dissent correctly notes that the Supreme Court struck down the entire statute in Wyoming v. Oklahoma, declining the state's invitation to construe the

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[3]Indeed, such a statute was struck down by the district court in Gulch Gaming.

legislation as applying only to the state-owned utility. We do not believe, however, that the Court's decision not to construe the statute as severable or as intended to apply only to the state-owned utility affects our analysis. Indeed, as we have pointed out, the Court expressly distinguished legislation such as that before us, and left to "the Oklahoma Legislature to decide whether it wishe[d] to burden [its] state-owned utility when private utilities will otherwise be free of . . . restrictions." Id. See also SSC Corp. v. Town of Smithtown, 66 F.3d 502, 512 (2d Cir. 1995) (holding that, although the county was a market participant in the waste disposal business, the county could not compel private parties to buy services from the local incinerator), cert. denied, 116 S. Ct. 911 (1996); Atlantic Coast Demolition & Recycling, Inc. v. Board of Chosen Freeholders, 48 F.3d 701, 717 (3d Cir. 1995) (holding that the state was not a market participant when it was using its regulatory power to go beyond its own participation and to control the market activities of private market participants); Swin Resources Sys., Inc. v. Lycoming County, 883 F.2d 245, 250 (3d Cir. 1989) (upholding allegedly discriminatory rules concerning the county's landfill because they did "not apply to private landfills and d[id] not apply beyond the immediate market in which [the county] transact[ed] business."). The issue before us does not involve the state using "its regulatory power to control other[] participants in the [gaming] market." Atlantic Coast Demolition & Recycling, Inc. 48 F.3d at 717. Rather, it involves a decision integral to the state's choice, as a business, as to whom it will deal with as operators.

The state's use of a licensing scheme rather than a contractual agreement does not take this case outside

of the market participation doctrine, as the plaintiffs contend. See, e.g., Alexandria Scrap, 426 U.S. at 808-10 (holding that a state was acting as a market participant in its statutory scheme of giving in-state scrap processors preferential treatment); Charities, 82 F.3d at 799-800 (holding that a statute determining the eligibility for participation in a state employees' charitable fund raising drive falls within the market participation doctrine). The state, like any private gaming company, is free to choose those with whom it will deal, be it through licensure or contract.

The plaintiffs and the dissent argue that South Dakota's involvement in virtually every aspect of the South Dakota Lottery, as expressed in South Dakota's amended constitution and state legislation, reveals that the state is actually regulating the market. We agree that the state's involvement is pervasive, but cannot agree that this involvement is regulation of "the market." To the contrary, we believe the state is administering its own business. The state, like the private gaming companies, is entitled to manage its business.

Finally, the plaintiffs argue that the market participation exception does not apply to this case because, by state constitutional mandate, the state of South Dakota has a monopoly in the video lottery business in South Dakota. Thus, the plaintiffs argue, the state is acting in its sovereign capacity. The Ninth Circuit Court of Appeals used this reasoning in Western Oil & Gas Ass'n v. Cory, 726 F.2d 1340 (9th Cir. 1984), aff'd without opinion by an equally divided Court, 471 U.S. 81 (1985). In that case, the state of California passed a statute and promulgated regulations, charging

oil refining companies by volume for transporting petroleum in pipelines over and across state-owned tidelands and submerged lands. When the companies filed a Commerce Clause challenge to the statute and regulations, the state argued that it was a market participant in the petroleum transport business. The Ninth Circuit disagreed, focusing on the permanency of the plaintiffs' refining facilities, which did not allow the plaintiffs any option but to lease from the state the submerged and tidewater lands upon which their pipelines rested. The court held that, under those facts, where the state had a monopoly and the companies had no choice but to renew their leases, the state was acting in its sovereign capacity as a regulator rather than as a market participant. Id. at 1343.

We are not entirely persuaded by the reasoning in Western Oil and Gas;[4] however, even if we were to agree, this case is different. This case does not concern an established business relationship between the state and a private party where the private party is raising a constitutional challenge to the state's unilateral change to the terms of the "contract." Nor does this case involve parties who are forced to continue to deal with the state because of the permanency of their facilities. Rather, it involves parties who are asserting they have a right to do business initially with the state, and the state determin-

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[4]Regardless of our doubt about the reasoning in Western Oil & Gas, we agree with the result because the state was not actively engaged in the narrowly defined market of oil transportation and was for that reason not a market participant in that industry.

ing that it does not want to do business with the parties. As such, we believe the plaintiffs' and the dissent's reliance on Western Oil & Gas is misplaced.[5] We further note that South Dakota's residency requirement for its own business does not preclude Chance Management from dealing with the various private gaming businesses in South Dakota.

Having considered the arguments presented on this issue, we hold that the state of South Dakota is acting as a market participant in the gaming market by operating the South Dakota Lottery. Further, we hold that the state's business decision to require that a majority interest of any corporate video lottery machine operator be held by South Dakota residents is not subject to Commerce Clause restrictions.

B. Equal Protection Clause

Sanders and Chance Management also contend that the residency requirement violates their equal protection rights under the Fourteenth Amendment.

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[5]The dissent finds the state's recent increase of its share of the State Lottery revenue to be relevant to this case. We respectfully disagree. Our "activity-by-activity analysis," see post at 20, is confined to whether the state's decision on the residency requirement falls within the market participation exception. Because neither Chance Management nor Sanders has challenged the state's decision to reap 50% of the revenue from its business (nor would they have standing to do so), we express no opinion on that issue.

The plaintiffs concede that rational basis review governs their equal protection challenge. Under the rational basis standard, we presume legislation is valid and will sustain it if the classification drawn by the statute is rationally related to a legitimate state interest. City of Cleburne v. Cleburne Living Ctr., Inc., 473 U.S. 432, 440 (1985). The statutory classification "need not be drawn so as to fit with precision the legitimate purposes animating it." Alexandria Scrap, 426 U.S. at 813. Instead, the plaintiffs have the burden of proving that the classification is so attenuated to its asserted purpose that the distinction it draws is wholly arbitrary and irrational. City of Cleburne, 473 U.S. at 446. Moreover, a party challenging the legislation must negate "every conceivable basis which might support it." FCC v. Beach Communications, Inc., 508 U.S. 307, 315 (1993) (internal quotations omitted). The plaintiffs contend that the state has not submitted a legitimate purpose for the residency requirement, and further, that the residency requirement is not related to any legitimate purpose.

We find that the residency requirement is rationally related to legitimate interests averred by the state. It is axiomatic that the state's first submitted interest, preventing illegal activities and infiltration by outside criminal elements into the South Dakota Lottery, is a legitimate purpose. Furthermore, we agree with the district court that "[g]ambling is generally understood to have a greater tendency to attract criminal infiltration than most other types of business enterprises." Chance Management, 876 F. Supp. at 212. We note that in furtherance of its interest in protecting against the infiltration of criminal elements, South Dakota closely monitors the video lottery machine operators. The state

undertakes an extensive background investigation on each applicant. Those investigations include contacts with foreign law enforcement bodies and sometimes require personal contact to conduct interviews and verify information. (J.A. at 50-51.) In addition, the state conducts periodic inspections of the operators' premises. (J.A. at 51.) While the state's use of a residency requirement to prevent criminal infiltration in its video lottery business may not be the perfect solution, a legislature could rationally conclude that the South Dakota Lottery can better protect the state's legitimate interests if the corporate operators of the machines – who maintain the video machines and who collect and temporarily hold large sums of money from them – are owned in major part by residents of South Dakota.

We also agree with the district court that the state has a legitimate interest in insuring that the state's substantial investment in its video lottery business ultimately benefits the South Dakota taxpayers. The legislature could have rationally concluded that a residency requirement would further this interest. Cf. Smith Setzer & Sons, Inc. v. S. C. Procurement Review Panel, 20 F.3d 1311 (4th Cir. 1994) (holding statute was rationally related to state's legitimate interest in directing benefits generated by state purchases to the citizens of the state).

Accordingly, we hold that § 42-7A-43 of the South Dakota Codified Laws does not violate the Equal Protection Clause of the Fourteenth Amendment.

C. Privileges and Immunities Clause

In their final claim, appellants argue that South Dakota's residency requirement violates the Privileges and Immunities Clause of Article IV, Section 2 of the United States Constitution, which states that "citizens of each State shall be entitled to all Privileges and Immunities of Citizens in the several States." The state responds that neither Chance Management nor Sanders has standing. The state further argues that if we hold that Sanders has standing, he should lose on the merits, because the South Dakota residency requirement does not burden a fundamental privilege or immunity covered by the Privileges and Immunities Clause, and because the state's interest in the profitability and the integrity of its business enterprise is sufficient to survive scrutiny.

We need not reach the questions of whether the Privileges and Immunities Clause reaches the residency requirement and whether the state has carried its burden of justifying the statute, for neither Chance Management nor Sanders has standing on this issue. As a corporation, Chance Management cannot raise the Privileges and Immunities claim. Western & S. Life Ins. Co. v. State Bd. of Equalization, 451 U.S. 648, 656 (1981). Sanders, who has not applied individually for a license as an operator and whose only "injury" is that flowing from his status as a shareholder of Chance Management, also lacks standing. Smith Setzer & Sons, 20 F.2d at 1311.

Sanders attempts to distinguish the cases holding that an individual's status as a shareholder is inadequate to create standing by noting that § 42-7A-43 prohibits

nonresident individuals, as well as corporations owned in majority by nonresidents, from obtaining operator licenses. The residency requirement for individual applicants is not at issue here, however, for no individual in this case has applied for an operator's license.

Sanders also points out that even though the corporation is the applicant in this case, he is by regulation required to meet individually the statutory requirements imposed by South Dakota Codified Laws § 42-7A-43, which provides for a background investigation and requires operators to meet certain qualifications to obtain a license. This argument is unpersuasive because it does not address the material question – whether Sanders has a cognizable injury under the Privileges and Immunities Clause. Regardless of the extra hurdles Sanders, as a shareholder, must overcome for Chance Management to obtain an operator's license, the potential injury that denying the license to Chance Management may cause to Sanders flows directly and solely from the alleged injury to Chance Management, which is "not constitutionally cognizable under the Privileges and Immunities Clause." Smith Setzer & Sons, 20 F.3d at 1317. We therefore hold that neither Chance Management nor Sanders has standing to bring the Privileges and Immunities Clause claim.

III.

For the foregoing reasons, we affirm the judgment of the district court.

LAY, Circuit Judge, dissenting.

With all due respect, the fundamental flaw in the majority's reasoning is the manner in which it frames the issue. The majority asks whether the state of South Dakota, in exclusively favoring its residents in the operation of a video lottery business, is acting as a "market participant" or a "market regulator." Upon finding that the state is a market participant in the video lottery business (indeed, it operates a monopoly) on account of its substantial investment in a central computer, software, and related expenses, the court declares it immune from Commerce Clause restrictions.[6]

The difficulty with the majority's stated approach is that it fails to ask whether, while acting as a market participant, the state has also illegally attempted to regulate the market. As the Second Circuit has explained, "[c]ourts must evaluate separately each challenged activity of the state to determine whether it constitutes participation or regulation." USA Recycling, Inc. v. Town of Babylon, 66 F.3d 1272, 1282 (2d Cir. 1995), cert. denied, 116 S. Ct. 1419, and cert. denied, 116 S. Ct. 1452 (1996). Dissenting in Reeves, Justice Powell echoed this truism when he observed that "[s]tate action burdening interstate trade is no less state action because

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[6]The Commerce Clause restricts the states in discriminating against interstate commerce. Thus, the Supreme Court has generally recognized that the "'negative' aspect of the Commerce Clause prohibits economic protectionism–that is, regulatory measures designed to benefit in-state economic interests by burdening out-of-state competitors." New Energy Co. v. Limbach, 486 U.S. 269, 273-74 (1988).

it is accomplished by a public agency authorized to participate in the private market." Reeves, Inc. v. Stake, 447 U.S. 429, 451 (1980) (Powell, J., dissenting). Thus, the fact that a state may participate in the marketplace as a private firm does not mean it may otherwise regulate the market at will. Yet the majority reduces the distinction between market regulation and market participation to an either/or proposition.

The majority principally relies on Hughes v. Alexandria Scrap Corp., 426 U.S. 794, 810 (1976), and Reeves, 447 U.S. at 436. In neither of these cases, however, did the state exercise any regulatory authority resulting in a policy of discrimination. See Reeves, Inc. v. Kelley, 603 F.2d 736, 737 (8th Cir. 1979) (noting the complete absence of an "allegation that South Dakota regulated or restricted out-of-state sale of privately manufactured cement or exercised its police power to suppress competition in the manufacture or sale of cement"), aff'd, 447 U.S. 429 (1980).[7] More important-

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[7]Indeed, the Supreme court in Reeves expressly distinguished such cases in observing that:

> South Dakota has not sought to limit access to the State's limestone or other materials used to make cement. Nor has it restricted the ability of private firms or sister States to set up plants within its borders. Moreover, petitioner has not suggested that South Dakota possesses unique access to the materials needed to produce cement.

ly, Wyoming v. Oklahoma, 502 U.S. 437 (1992), directly refuted the majority's analysis. There the Court struck down an Oklahoma statute which required all public and private utilities within the state to supply ten percent of their fuel needs from Oklahoma-mined coal. While acknowledging that Oklahoma, as a participant in the coal market, could purchase coal from whomever it chose, id. at 461, the Court invalidated Oklahoma's regulatory conduct in imposing purchase requirements upon private utilities. Id. at 454-59.[8]

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447 U.S. at 444 (citation and footnote omitted).

Likewise, the Court in Hughes upheld Maryland's subsidization of the in-state automobile scrap metal processing market on the ground that, while the "practical effect" of the challenged scheme "was that the movement of hulks in interstate commerce was reduced," it "did not accomplish this effect directly." 426 U.S. at 803 & n.13. The Court distinguished prior cases involving "interfere[nce] with the natural functioning of the interstate market either through prohibition or through burdensome regulation," concluding that "Maryland has not sought to prohibit the flow of hulks, or to regulate the conditions under which it may occur. Instead, it has entered into the market itself to bid up their price." Id. at 806.

[8]Because the Court found it impracticable to sever that portion of the statute governing state-owned utilities, it declared the Act as a whole unconstitutional. Id. at 459-61.

In discussing Wyoming v. Oklahoma, the majority takes comfort in the Supreme Court's observation that were the Oklahoma law construed to apply only to the state-owned public utility (Grand River Dam Authority) (GRDA) the statute "would become a fundamentally different piece of legislation." Ante at 11 (citing Wyoming v. Oklahoma, 502 U.S. at 461). If the law struck down in Wyoming v. Oklahoma were applied only to the GRDA, and the market participant exception were applied, private utilities would be free to make their own decisions from whom they might buy coal unimpeded by government regulation. In contrast, because of the way South Dakota has structured and regulated the video lottery market, private companies are not free to do business unimpeded by government regulation, without facing criminal penalties. Beyond choosing its own "business partners," South Dakota has regulated all actors in the video lottery market by prohibiting transactions between private parties. Although South Dakota is participating in the market, its statutory commands reach beyond merely dictating terms to its "business partners," and therefore its regulation of the video lottery market is similar to the law struck down in Wyoming v. Oklahoma.

In contrast to the analysis urged by the majority, the decisions of several other circuits support an activity-by-activity analysis where the state both regulates and participates in the relevant market. In Atlantic Coast Demolition & Recycling, Inc. v. Board of Chosen Freeholders, for example, the Third Circuit observed:

> When a public entity participates in a market, it may sell and buy what it choos-

> es, to or from whom it chooses, on terms of its choice; its market participation does not, however, confer upon it the right to use its regulatory power to control the actions of others in that market.

48 F.3d 701, 717 (3d Cir. 1995); accord SSC Corp. v. Town of Smithtown, 66 F.3d 502, 513 (2d Cir. 1995), cert. denied, 116 S. Ct. 911 (1996). The Second Circuit has likewise stated:

> [The Town of] Babylon has exercised its governmental powers by denying licenses to all garbage haulers but the one hired by the Town, and by establishing civil and criminal penalties for haulers who collect garbage without a license. Because no private actor could engage in such activity, the Town is acting as a market regulator rather than a market participant. The Town does 'participate' in the garbage collection market in a different respect: it buys garbage hauling services from BSSCI. But states and local governments do not enjoy carte blanche to regulate a market simply because they also participate in that market. Particular state actions that do not constitute 'market participation' are subject to the limitations imposed by the Commerce Clause. A state engaging in mercantile activity does not obtain blanket immunity to regulate the market in which it participates, free from the strictures of the dormant Commerce Clause.

USA Recycling, 66 F.3d at 1282 (citations omitted).

Similarly, in Western Oil & Gas Ass'n v. Cory, 726 F.2d 1340 (9th Cir. 1984), aff'd without opinion by an equally divided court, 471 U.S. 81 (1985), the Ninth Circuit recognized that a state's ownership interest in a market does not exempt its regulation of the market from Commerce Clause scrutiny. Western Oil & Gas involved a California scheme to collect a volume-based "rent" from off-coast refineries for the leasing of state-owned tidelands over which they transported oil. The state contended that its leasehold activities fell outside the scope of the Commerce Clause on the basis that, as owner of the tidelands, it acted in a proprietary capacity in renting them. Id. at 1342. The court rejected that argument:

> The State owns and controls tidelands and submerged lands in its sovereign capacity. Although some of the lands are in the possession of local State entities or private interests, this does not mean that California becomes one of many competitors. The permanency of plaintiffs' facilities does not permit them to "shop around". There is no other competitor to which they can go for the rental of the required strip of California coastline. The Commission has a complete monopoly over the sites used by the oil companies. The companies have no choice but to renew their leases despite the volumetric rate, as the oil, gas and petroleum-derived products cannot be transported to plaintiffs'

> facilities without traversing the state-owned lands. This control over the channels of interstate commerce permits the State to erect substantial impediments to the free flow of commerce. We therefore reject the State's contention that its leasing activities are not subject to Commerce Clause scrutiny.

Id. at 1343 (emphasis added and citations omitted).

There was no doubt in Western Oil & Gas that the state owned the tidelands over which the refineries transported their oil. Yet the fact that it wielded monopolitistic power, and as such was a market participant, did not deter the court from holding that its regulatory function was subject to dormant Commerce Clause scrutiny.

The majority dismisses Western Oil & Gas on the ground that the present case "does not involve parties who are forced to deal with the State in a monopoly situation that falls outside the reach of free market forces," but rather "parties who are asserting they have a right to do business initially with the State, and the state determining that it does not want to do business with the parties." Ante at 14. This characterization slights the fact that in deciding that it "does not want to do business" with Chance, the state has also foreclosed the opportunity for Chance "to do business" with anyone else, much as the refineries in Western Oil & Gas were foreclosed from dealing with other landowners. If the rationale behind market participation doctrine is genuinely evenhandedness, see Reeves, 447 U.S. at 439

(where "state proprietary activities" are "burdened with the same restrictions imposed on private market participants," then "[e]venhandedness" supports invocation of market participant doctrine), then it would seem that South Dakota must take the bitter with the sweet: it may not enter the market as a purchaser of video lottery operation services while precluding, through the use of its regulatory power, all potential competitors from entering the market.[9] If anything, the instant case presents facts more compelling than Western Oil & Gas for not applying the market participant exception, for the state has a monopoly over video lottery as a direct result of its own regulations, and not merely by "happenstance."[10] See Reeves, 447 U.S. at 444; see also C & A Carbone, Inc. v. Town of Clarkstown, 114 S. Ct. 1677, 1682 (1994) ("With respect to this stream of commerce, the flow control ordinance discriminates, for it allows only the favored operator to process waste that is within the limits of the town."); id. at 1683 ("[T]hat the flow control ordinance favors a single local proprietor . . . just makes the protectionist effect of the ordinance more acute.").

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[9]At oral argument South Dakota conceded that, if the market participation exception does not apply, its interests in regulating Chance's activity do not withstand Commerce Clause scrutiny.

[10]Theoretically the refineries involved in Western Oil & Gas could have dealt with other landowners; only the cost prohibited them from so doing. Here, by contrast, entry into the market is not cost prohibitive, but constitutionally and statutorily forbidden.

There should be little question in the present case that South Dakota is not simply exercising a private choice as to the parties with whom it will trade.[11] Indeed, by its own constitutional and legislative enactments the state concedes that it is regulating the market.[12] Pursuant to the constitutional grant of authority

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[11]The majority, seemingly anxious to broaden the market in question and to minimize the scope of South Dakota's complete monopoly in video lottery, states that South Dakota "created a state business within the gaming market," ante at 7, and adds that "South Dakota's residency requirement for its own business does not preclude Chance Management from dealing with the various private gaming businesses in South Dakota." Ante at 14. These statements cannot soften the fact that South Dakota made itself the only "partner" with whom plaintiffs may enter the video lottery business. To suggest that the plaintiffs can merely go elsewhere into other private gaming is a tacit admission that the state has regulated the video lottery market, and seems to ignore the majority's own command that the court's inquiry is limited to analyzing a narrowly defined market.

[12]Article III, § 25 of the South Dakota Constitution, for example, provides in relevant part:

> The Legislature shall not authorize any game of chance lottery, or gift enterprise, under any pretense, or for any purpose whatever .... However, it shall be lawful for the Legislature to authorize by law a

within Section 25, the South Dakota legislature has delegated to the South Dakota Lottery Commission the "overall management" and "control over the operation of [lottery] games." S.D. Codified Laws Ann. § 42-7A-2 (Michie Supp. 1995). Likewise, § 42-7A-21 authorizes the Commission to promulgate "[r]ules and regulations" concerning seventeen aspects of the lottery, including "[a]dditional qualifications for . . . operators, . . . the

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> state lottery or video games of chance, or both, which are regulated by the state of South Dakota, either separately by the state or jointly with one or more states, and which are owned and operated by the state of South Dakota, either separately by the state or jointly with one or more states or persons, provided any such video games of chance shall not directly dispense coins or tokens. However, the Legislature shall not expand the statutory authority existing as of June 1, 1994, regarding any private ownership of state lottery games or video games of chance, or both. The Legislature shall establish the portion of proceeds due the state from such lottery or video games of chance, or both, and the purposes for which those proceeds are to be used. SDCL 42-7A, and its amendments, regulations, and related laws, and all acts and contracts relying for authority upon such laws and regulations, beginning July 1, 1987, to the effective date of this amendment, are ratified and approved.

amount of application fees to be paid," id. § 42-7A-21(7), and "[l]icensing procedures," id. § 42-7A-21(16). As South Dakota admits in its brief: "The State's involvement in video lottery is pervasive. Virtually every aspect of video lottery operations is owned, operated, specified, controlled or monitored by the State." Brief for Appellees at 12.

Although the majority asserts that South Dakota "is free to choose those with whom it will deal, be it through licensure or contract," ante at 13, the granting and denial of licenses is far more akin to market regulation than to market participation. Public licensure is not generally contractual in nature: a license neither grants the licensee a property right nor creates a mutual obligation.[13] If anything, public licensing constitutes a "pri-

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[13]One authority defines "license" (in part):

> A permit, granted by an appropriate governmental body, generally for a consideration, to a person, firm, or corporation . . . to carry on some business subject to regulation under the police power. A license is not a contract between the state and the licensee, but is a mere personal permit. Neither is it property or a property right.

Black's Law Dictionary 829 (5th ed. 1979) (citations omitted). The final phrase in the quoted passage is helpful in light of the public policy declaration found in S.D. Codified Laws Ann. § 42-7A-56(3) (Michie Supp.

meval governmental activity" such as the taxation scheme favoring in-state residents found to fall outside of the market participant exception in Limbach, 486 U.S. at 277.

1995):

> No applicant for a license or other affirmative commission action has any right to a license or to the granting of the approval sought. Any license issued or other commission approval granted pursuant to the provisions of this chapter is a revocable privilege, and no holder acquires any vested interest or property right therein or thereunder.

Accordingly, this section too suggests the state's licensing scheme is regulatory, not proprietary, in nature, for a contract creates bargained for rights and obligations. Compare, e.g., Rushmore State Bank v. Kurylas, Inc., 424 N.W.2d 649, 653 (S.D. 1988) (noting that "there are property rights in the [liquor] license as between the licensee and third parties such as creditors," but "there clearly is no general property right in the license in South Dakota as between the state and the licensee") with Black's Law Dictionary at 291-92 (5th ed. 1979) (defining "contract" (in part) as "[a]n agreement between two or more persons which creates an obligation to do or not to do a particular thing. Its essentials are competent parties, subject matter, a legal consideration, mutuality of agreement, and mutuality of obligation.").

The state concedes that licensing normally entails authorizing private "individuals to pursue private occupations that demand a minimum level of proficiency, skill and competency," but contends that its lottery licensing regime merely "provides the individual or business with the ability to participate in the State's video lottery business enterprise." Brief for Appellees at 16. This assertion (which is unsupported by any authority) is dubious, given the substantial eligibility requirements delineated in S.D. Codified Laws Ann. §§ 42-7A-13 and 42-7A-14 (Michie Supp. 1995). The granting and denial of public licenses clearly constitutes market regulation. See Reeves, 447 U.S. at 440; cf. Richard A. Epstein, The Permit Power Meets the Constitution, 81 Iowa L. Rev. 407, 414 (1995) (["N]o matter how generous a view one takes of the permit power, one still must distinguish between the state as regulator and the state as owner. Quite bluntly, the power to issue a permit does not–or at least should not–make the state a part owner of the property.").

The state's unilateral decision to increase its share of video lottery revenues from 35 to 50 percent also detracts from its argument that it is not regulating the video lottery market. See S.D. Codified Laws Ann. § 42-7A-63 (Michie Supp. 1995). In a competitive market, such an increase in a licensor's share of revenues would normally be the product of bilateral negotiations in which the possibility of losing the licensee to a competitor would serve to limit the licensor's bargaining power. Here, however, the state has no competitors, for it has erected a legal barrier to their entry into the video lottery market. Private entities enjoy no such comparable power. See SSC Corp., 66 F.3d at 512 ("A state's

actions constitute 'market participation' only if a private party could have engaged in the same actions."). Characterizing the state's activity as a "refusal to deal" with nonresident corporations is therefore misleading. Compare United States v. Colgate & Co., 250 U.S. 300, 307 (1919) ("In the absence of any purpose to create or maintain a monopoly, the [Sherman] act does not restrict the long recognized right of trader or manufacturer engaged in an entirely private business, freely to exercise his own independent discretion as to parties with whom he will deal.") with Eastman Kodak Co. v. Southern Photo Materials Co., 273 U.S. 359, 375 (1927) (finding refusal to deal "in pursuance of a purpose to monopolize" illegal under the Sherman Act). Cf. Epstein, supra at 416 ("In ordinary markets, if you don't like the terms that people offer, you can go elsewhere. But there is no effective exit right when the state asserts its permit power. The state, which has a stranglehold on individual behavior, must be told to relax its grip." (footnote omitted)).

To be sure, South Dakota "participates" at some level in the video lottery market each time it "contracts" with a state-licensed video lottery operator, and the majority is quite correct to reject Chance's argument that the market participant doctrine is limited to circumstances in which a state formally acts as a buyer, seller, or employer.[14] Under South Dakota's licensing scheme,

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[14]See South-Central Timber Dev., Inc. v. Wunnicke, 467 U.S. 82, 97 (1984) (plurality opinion) ("privity of contract is not always the outer boundary of permissible state activity"); White v. Massachusetts Council of

however, only corporations owned in their majority by residents are permitted to enter the video lottery market; nonresident-owned corporations are "removed from the market altogether," Reeves, 447 U.S. at 444 n.17, for one may not operate a video lottery machine without a license, and doing so is in fact punishable as a felony. See S.D. Codified Laws Ann. § 42-7A-39 (1991). Imposing criminal penalties may not fairly be considered an act of a market participant. See SSC Corp., 66 F.3d at 512. Pursuant to its state constitution, South Dakota is the exclusive "purchaser" of video lottery operation services; there is no residual market in which Chance might sell its services, nor is there any residual purchaser who might buy them. See S.D. Const. Art. III, § 25 ("The Legislature shall not authorize any game of . . .

Constr. Employers, Inc., 460 U.S. 204, 211 n.7 (1983) ("[T]he Commerce Clause does not require the city to stop at the boundary of formal privity of contract."); Reeves, 447 U.S. at 438 n.10 (noting that "States may fairly claim some measure of a sovereign interest in retaining freedom to decide how, with whom, and for whose benefit to deal"); Reeves, 603 F.2d at 737 n.1 (a state possesses "'unrestricted power to produce its own supplies, to determine those with whom it will deal, and to fix the terms and conditions upon which it will make needed purchases'" (quoting Perkins v. Lukens Steel Co., 310 U.S. 113, 127 (1940)), aff'd, 447 U.S. 429 (1980); Independent Charities of Am., Inc. v. Minnesota, 82 F.3d 791, 799 (8th Cir. 1996) (finding "no well-founded reason to constrict the proprietary activities covered by the market participant exception to acts of buying or selling").

lottery . . . .").[15] South Dakota's activity therefore bears all of the hallmarks of public licensing and regulation, and it is inaccurate to characterize its video lottery arrangement as market "participation." See Wunnicke, 467 U.S. at 97 (plurality opinion) (market participant doctrine "does not validate any requirement merely because the State imposes it upon someone with whom it is in contractual privity").

Under the scheme set out by the South Dakota legislature, it should be obvious that the state is using its police powers to regulate the video lottery in a manner that precludes an evenhanded comparison to a private entrepreneur. There is little question that its "regulatory measures [are] impeding free private trade in the national marketplace." Reeves, 447 U.S. at 437. Unfortunately, Chance has no opportunity to compete on equal footing with the state.

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[15]The baseline against which the state's activity should be measured is therefore not a market open to nonresident competitors, but a completely foreclosed market. See Reeves, 447 U.S. at 444 n.17 ("The 'bottom line' of the scheme closely parallels the result in Alexandria Scrap: out-of-state concrete suppliers are not removed from the market altogether; to compete successfully with in-state competitors, however, they must achieve additional efficiencies or exploit natural advantages such as their location to offset the incremental advantage channeled by the State's own market behavior to in-state concrete suppliers.").

I must, therefore, respectfully dissent.

A true copy.

Attest:

CLERK, U. S. COURT OF APPEALS, EIGHTH CIRCUIT.

APPENDIX B
United States District Court Opinion
Entered February 21, 1995

CHANCE MANAGEMENT, INC., a South Dakota corporation, and William A. Sanders, a Wyoming resident, Plaintiffs,
v.
STATE OF SOUTH DAKOTA; Mark W. Barnett in his official capacity as Attorney General of South Dakota; the South Dakota Lottery; Susan Walker, in her official capacity as Executive Director of the South Dakota Lottery; and H.I. King, Beverly McCracken, Elaine Emery, Don Bender, Burdette Solum, and John E. Carmody, Sr., in their official capacities as members of the South Dakota
Lottery Commission, Defendants.

Civ. No. 94-3002.
United States District Court,
D. South Dakota,
Central Division.
Feb. 21, 1995.

***210** Steven W. Sanford, Cadwell, Sanford & Deibert, Sioux Falls, SD, for plaintiffs.

Jeffrey P. Hallem, Asst. Atty. Gen., Pierre, SD, for defendants.

Lee M. McCahren, Vermillion, SD, for S.D. Lottery.

MEMORANDUM OPINION AND ORDER
JOHN B. JONES, Senior District Judge.

Plaintiff Chance Management, Inc. (Chance) is a South Dakota corporation whose majority stock ownership is held by plaintiff William A. Sanders (Sanders), a Wyoming resident. SDCL s 42-7A-43 restricts licenses for video lottery machine operators (machine operators) to South Dakota residents, or partnerships or corporations whose majority ownership is held by South Dakota residents. After Chance was denied a video lottery machine operator's license, the plaintiffs brought this suit to challenge the constitutionality of the residency requirement.

Both sides moved for summary judgment. For the reasons set out below, summary judgment will be granted to the defendants.

Background

The South Dakota Lottery commenced operation in 1989. 1989 S.L., ch. 374. It is regulated in considerable detail by the South Dakota Lottery Commission. SDCL Ch. 42-7A. The lottery business is broken down by statute into four divisions, each of which is separately licensed. SDCL s 42-7A-41.

The video lottery machine manufacturers and video lottery machine distributors are separately licensed, and their roles in the business are self-explanatory. The video lottery establishment or retailer operates the premises where the machines are available to the public for play.

The machine operator purchases the video lottery terminals (machine) from the distributor and owns,

maintains and places the machines in the retail establishments.

The State of South Dakota dictates to manufacturers the electronic circuitry required and owns the programs in the logic boards and the Erasable, Programmable Read Only Memory (EPROM) chips in the machines. The state's central computer is connected to each machine and controls payouts and maintains a record of the machine's usage.

The state's share of the net machine revenue generated by each machine started at 22 per cent, is now at 37 per cent, and legislation is pending to raise it to 50 per cent. The state's share is collected every two weeks from the machine operator by means of electronic "sweeps" of the operator's bank account.

Discussion

Chance and Sanders challenge the video lottery operator license residency requirement on the basis that it violates the Commerce Clause, the Equal Protection Clause, and the Privileges and Immunities Clause of the United States Constitution. These issues will be addressed in that order.

***211** I. Commerce Clause.

The Commerce Clause reserves to Congress the power to "regulate Commerce ... among the several States." U.S. Const. art. I, s 8, cl. 3. The state argues that the residency requirement is not subject to Com-

merce Clause scrutiny because the state is acting as a market participant.

The market participant exception has been recognized by the United States Supreme Court in three instances: Hughes v. Alexandria Scrap Corp., 426 U.S. 794, 96 S.Ct. 2488, 49 L.Ed.2d 220 (1976), (holding that the state of Maryland was a participant in the market of purchasing junk car hulks through a bounty system); Reeves, Inc. v. Stake, 447 U.S. 429, 100 S.Ct. 2271, 65 L.Ed.2d 244 (1980), (holding that the South Dakota State Cement Plant was a market participant as a seller of cement products); and White v. Massachusetts Council of Construction Employers, Inc., 460 U.S. 204, 103 S.Ct. 1042, 75 L.Ed.2d 1 (1983), (holding that the city of Boston was acting as a market participant when it contracted for public works construction).

It has also been the subject of law review articles, including Dan T. Coenen, Untangling the Market-Participant Exemption to the Dormant Commerce Clause, 88 Mich.L.Rev. 395 (1989) and Barton B. Clark, Comment, Give 'Em Enough Rope: States, Subdivisions and the Market Participant Exception to the Dormant Commerce Clause, 60 U.Chi.L.Rev. 615 (1993).

The Supreme Court cases "make clear that if a State is acting as a market participant, rather than a market regulator, the dormant Commerce Clause places no limitation on its activities." South-Central Timber Dev., Inc. v. Wunnicke, 467 U.S. 82, 93, 104 S.Ct. 2237, 2243, 81 L.Ed.2d 71 (1983) (citations omitted). The rationale for this exception is that the state, having

entered a market, should be allowed to operate freely as any other business would in that market. "[T]he Commerce Clause responds principally to state tax and regulatory measures impeding free private trade in the national marketplace. There is no indication of a constitutional plan to limit the ability of States themselves to operate freely in the free market." Reeves, 447 U.S. at 436-37, 100 S.Ct. at 2277 (citations omitted). "[T]he competing considerations in cases involving state proprietary action often will be subtle, complex, politically charged, and difficult to assess under traditional Commerce Clause analysis." Id. at 439, 100 S.Ct. at 2279. These considerations favor leaving the states unfettered when acting as a market participant.

This case is a perfect example of that mix of concerns. The record convinces me that the State of South Dakota is a market participant with the machine operators in the operation of the South Dakota State Lottery for a number of reasons.

First, the enterprise has always been known as the "State Lottery", SDCL Ch. 42-7A, which at least implies that the state has a controlling interest in its operation and management.

Second, the state dictates the makeup of the electronic programs and chips built into the machines.

Third, the state requires that all machines be connected with and controlled by the state's central computer system, including controlling the payouts of the machines.

Fourth, the state requires that each machine be given an ID number which is programmed into its logic board and EPROM chip, to permit the state to track the machine and its key internal components.

Fifth, the substantial investment in the state's central computer system, software, personnel and equipment to allow the operation of the video lottery is clearly a proprietary interest.

Sixth, the state takes a share of the net take of the machines, now 37%, which far exceeds any reasonable regulatory license fee, and being a very substantial portion of the gross profit generated by the machines, makes this proprietary interest even stronger.

And, finally, the state controls the lottery business in great detail through its statutes, SDCL Ch. 42-7A, and regulations adopted by the South Dakota lottery commission, S.D.Admin.Rules, Title 48.

***212** The gambling business differs from other types of commerce because of the potential for cheating, abuse or criminal infiltration. This provides motivation to retain control over the business to the fullest extent practicable. In this case, the video lottery can only be played on machines within the state of South Dakota, so there is no concern over the restraint of the national or foreign market in gambling.

The determination would be clearer if the state contracted with, rather than licensed, the operators. However, a contractual relationship has never been required for the market participant exception. See

Hughes v. Alexandria Scrap, 426 U.S. at 803, 96 S.Ct. at 2494 (bounty on junk car hulks not based on contract).

The case falls more closely in line with the facts and reasoning of White than the regulatory line of cases such as South-Central Timber Development. South Dakota is a market participant in the video lottery business, and the Commerce Clause challenge must fail. "Nothing in the purposes animating the Commerce Clause prohibits a state, in the absence of congressional action, from participating in the market and exercising the right to favor its own citizens over others." Alexandria Scrap, 426 U.S. at 810, 96 S.Ct. at 2498 (footnote omitted).

Market participation distinguishes this case from Gulch Gaming, Inc., v. South Dakota, 781 F.Supp. 621 (D.S.D.1991). In that case, the Court found that the residency requirements for Deadwood gaming operator and retail licenses in SDCL s 42-7B-25 violated the Commerce Clause. Deadwood gambling is privately owned and operated; the state merely regulates these activities and collects license fees and taxes, which are distributed as set forth by statute. See SDCL Ch. 42-7B. No state market participation is involved in Deadwood gambling operations.

II. Equal Protection Clause.

Both Plaintiffs and Defendants agree that the standard to be applied in this case is that of the rational basis test because no fundamental right or suspect class is implicated. See City of Cleburne v. Cleburne Living

Ctr., Inc., 473 U.S. 432, 440, 105 S.Ct. 3249, 3254, 87 L.Ed.2d 313 (1985).

In setting up the video lottery business, the state was commencing a gambling operation different from that which had ever operated in South Dakota, or for that matter, anywhere else in the country. Gambling is generally understood to have a greater tendency to attract criminal infiltration than most other types of business enterprises.

Video lottery as established by statute made the machine operator the most important player in the lottery business: the operator owned the machines, placed them in the retail establishments, serviced them, and handled all the money generated by the machines. The state could have rationally believed that resident machine operators would be less likely to bring to South Dakota employees with criminal backgrounds or tendencies than would non- resident machine operators. Fendrich v. Van DeKamp, 182 Cal.App.3d 246, 227 Cal.Rptr. 262, 270 (1986) (state has a legitimate interest in preventing corruption in authorized gambling). It could also rationally believe that it would be easier to collect the state's share of the revenue from resident machine operators than non-resident machine operators.

The legitimate purposes of the state in this case are rationally related to the residency requirement. In addition to factors previously stated, it also clearly encourages local economic development in the state, maximizes local revenues from video lottery, and could reduce some investigative costs. As long as the legislature "could rationally have decided " the requirement

furthers legitimate state goals, the Equal Protection Clause is satisfied. Minnesota v. Cloverleaf Creamery Co., 449 U.S. 456, 466, 101 S.Ct. 715, 725, 66 L.Ed.2d 659 (1981) (emphasis in original).

The business reasons for the residency requirement, in addition to the concerns over avoiding crime-related problems, distinguish this case from Gulch Gaming, 781 F.Supp. 621.

The state expressed legitimate reasons for the residency requirement, and "the Equal Protection Clause permits economic regulation ***213** that distinguishes between groups that are legitimately different–as local institutions so often are." Northeast Bancorp v. Board of Governors of Fed. Reserve Sys., 472 U.S. 159, 180, 105 S.Ct. 2545, 2556, 86 L.Ed.2d 112 (O'Connor, J. concurring). The rational basis test is satisfied unless there is no reasonable conception that could justify the state's action and ... the legislative actors were cognizant of this at the time they acted. In the absence of evidence of such arbitrary and irrational behavior on the part of the legislature, the statute must survive rationality review. Smith Setzer & Sons, Inc. v. South Carolina Procurement Review Panel, 20 F.3d 1311, 1324 (4th Cir.1994). The Court cannot say that the rationality of the connection between the residency requirement and the state's purposes is so lacking as to make it a "wholly arbitrary act" inconsistent with the Equal Protection Clause. New Orleans v. Dukes, 427 U.S. 297, 303-04, 96 S.Ct. 2513, 2516-17, 49 L.Ed.2d 511 (1976).

III. Privileges and Immunities Clause.

A corporate plaintiff is not a "citizen" as that term is used in the Privileges and Immunity Clause and it is settled law that the Clause is inapplicable to corporations. Western & Southern Life Ins. Co. v. State Bd. of Equalization, 451 U.S. 648, 656, 101 S.Ct. 2070, 2077, 68 L.Ed.2d 514 (1981). William A. Sanders, as an individual, also asserts that his rights under the Clause are violated by the residency requirement. The state challenges his standing to assert this claim.

Shareholders with an identifiably direct and personal interest in a cause of action can bring suit individually to assert rights that also implicate the corporation's rights. Franchise Tax Bd. v. Alcan Aluminum, Ltd., 493 U.S. 331, 336, 110 S.Ct. 661, 665, 107 L.Ed.2d 696 (1990). The shareholder must also have suffered an "injury in fact" caused by the challenged state statute, which would likely be redressed by the relief sought. Lujan v. Defenders of Wildlife, — U.S. —, —, 112 S.Ct. 2130, 2136, 119 L.Ed.2d 351 (1992). Sanders is not injured in any way separate from the corporation by the residency requirement. Sanders can be a director, employee or corporate officer of the corporation without triggering the residency restriction of SDCL s 42-7A-2. That restriction only prevents the corporation from gaining a license in South Dakota to operate video lottery.

Sanders' cites Cooper v. McBeath, 11 F.3d 547 (5th Cir.1994) as supporting his argument that he has standing to assert a Privileges and Immunities claim. That case is factually distinguishable. The nonresident

minority shareholders in that case held an option to purchase the remaining shares in a corporation that had already secured a Texas liquor permit.

The shareholders challenged the state permit residency requirement which prevented them from gaining majority ownership while maintaining the liquor permit. The shareholders brought suit individually. The court in Cooper did not address the question of whether the Privileges and Immunities clause was violated. The rights Sanders seeks to assert are those of the corporation only, and as to the Privileges and Immunities Clause, he has no injury in fact separate from the corporation. He has no standing to assert this claim. Smith Setzer & Sons, 20 F.3d at 1316-18.

Conclusion

Commerce Clause restrictions do not apply in this case because the state is acting as a market participant. The Equal Protection Clause is not violated because the state has legitimate purposes which are rationally related to the residency requirement. Plaintiff Sanders has no standing to challenge the statute as to the Privileges and Immunities Clause.

Therefore, upon the record herein,

IT IS ORDERED:

(1) That Plaintiffs' Motion for Summary Judgment, Doc. 16, is denied.

(2) That Defendants' Cross-Motion for Summary Judgment, Doc. 24, is granted.

*214 (3) The Clerk of Courts shall enter a Judgment in favor of the Defendants in accordance with this Order.

APPENDIX C
Cited Statutes and Regulations

Statutes:

42-7A-1. *State lottery - Definitions.

Terms used in this chapter mean:

(6) "Licensed establishment," a bar or lounge owned or managed by an individual, partnership, corporation or association licensed to sell alcoholic beverages for consumption upon the premises where sold;

42-7A-2. *State Lottery -

There is hereby established an independent state agency to be called the South Dakota lottery under the direction of the South Dakota lottery commission. Under the supervision of the commission, an executive director shall administer the state lottery as provided in this chapter. In all decisions, the executive director and commission shall take into account the particularly sensitive nature of the lottery, and shall act to promote and ensure the integrity, security, honesty and fairness of its operation and administration. The overall management of the state lottery and control over the operation of its games shall rest solely with the South Dakota lottery.

42-7A-4. *State Lottery -

The executive director may, subject to policy established by the commission:

(11A) The lottery commission shall operate a video lottery undertaken pursuant to this chapter and may not contract or assign this responsibility to any other person;

42-7A-13. *State Lottery -

To be selected as a lottery retailer or video lottery machine operator, a natural person acting as a sole proprietor shall:

(1) Be at least eighteen years of age;

(2) Be of good character and reputation;

(3) Have sufficient financial resources to support the activities required to sell lottery tickets or place and service video lottery machines; and

(4) Be current in payment of all taxes, interest and penalties owed to the state of South Dakota, excluding items under formal dispute or appeal pursuant to applicable statutes.

A lottery retailer or video lottery machine operator may not be a lottery vendor or an employee or agent of any lottery vendor doing business with the South Dakota lottery.

42-7A-14. *State Lottery -

No natural person may be licensed by the lottery or involved in lottery activities under this chapter, who:

(1) Has been convicted of a felony in this or any other jurisdiction, unless at least ten years have passed since satisfactory completion of the sentence or probation imposed by the court in each such felony;

(2) Has been found to have violated the provisions of this chapter or any rule adopted pursuant to this chapter;

(3) Has been found to have a background, including a criminal record, reputation, habits, social or business associations or prior activities that pose a threat to the public interests of the state or to the security and integrity of the lottery; create or enhance the dangers of unsuitable, unfair or illegal practices, methods and activities in the conduct of gaming; or present questionable business practices and financial arrangements incidental to the conduct of lottery activities;

(4) Is a member of the immediate family, as defined in §42-7A-33, of an employee of the South Dakota lottery or of a member of the South Dakota lottery commission; or

(5) Has knowingly made a false statement of material fact to the South Dakota lottery.

42-7A-37. *State Lottery -

Each video lottery machine licensed under this chapter:

(1) Shall offer only games licensed by the South Dakota lottery and authorized by the commission;

(2) May not have any means of manipulation that affect the random probabilities of winning a video lottery game;

(3) Shall have one or more mechanisms that accept coins or cash in the form of bills. The mechanisms shall be designed to prevent obtaining credits without paying by stringing, slamming, drilling or other means. If such attempts involve physical tampering, the machine shall suspend itself from operation until reset;

(4) Shall have nonresettable meters housed in any readily accessible locked machine area that keep a permanent record of all cash inserted into the machine, all refunds of winnings made by the machine's printer, credits played for video lottery games and credits won by video lottery players;

(5) Shall be capable of printing a ticket voucher stating the value of the prize for the player at the completion of each video lottery game; the time of day in a twenty-four hour format showing hours and minutes; the date; the machine serial number; the sequential number of the ticket vouchers; and an encrypted validation number from which the validity of the prize may be determined;

(6) Shall have accounting software that keeps an electronic record which includes, but is not limited to the following: total cash inserted into the machine; the value of winning tickets claimed by players; the total video lottery credits played and the total video lottery credits awarded by a video lottery game; and the payback percentage credited players of each video lottery game;

(7) Shall be linked under a central communications system to provide auditing program information as approved by the commission. The communications system shall be installed and all testing conducted no later than December 1, 1989. Until such time, all accounting of machine transactions shall be audited by electronic records maintained by each video lottery machine as required in subdivision (6) of this section. In no event may the communications system approved by the commission limit participation to only one manufacturer of video lottery machines by either the cost in implementing the necessary program modifications to communicate or the inability to communicate with the central communications system. Nothing in this section may be construed as requiring a machine which only offers video lottery games to be on-line or in constant communication with a central computer.

42-7A-37.1. *State Lottery -

A business licensed pursuant to subdivision 35-4-2(12) and (16) may not be a licensed establishment for video lottery placement pursuant to subdivision 42-7A-1(6) unless it is a bar or lounge. For the purposes of this section, a bar or lounge is an enterprise primarily

maintained and operated for the selling, dispensing and consumption of alcoholic beverages on the premises and may also include the sale and service of food. A bar or lounge may be physically connected to another enterprise within the same building, which enterprise may be owned or operated by the same person. There may be interior access between a bar or lounge and a connected enterprise. However, there shall be a floor to ceiling opaque wall separation between the two enterprises. A separation wall may be constructed to provide visual and physical access for employees from areas in the building not open to the public. The bar or lounge shall have a separate entrance and exit. A separate entrance and exit is not required if entrance to the bar may only be obtained from the other distinct enterprise and the public may not enter the other enterprise by first passing through the bar or lounge. All video lottery machines shall be adequately monitored during business hours. Adequate monitoring shall be accomplished by the personal presence of an employee or by an employee using video cameras or mirrors and periodic inspections of the bar or lounge. No new license may be issued to any establishment after July 1, 1992, unless such establishment complies with this section. No license may be renewed to any establishment after July 1, 1993, unless such establishment complies with this section.

42-7A-41. *State Lottery -

Each video lottery machine manufacturer, distributor, operator and licensed establishment shall be licensed by the executive director before any video lottery machine or associated equipment is manufac-

tured, distributed, sold or placed for public use in this state. The commission shall, by rule promulgated pursuant to chapter 1-26, establish an annual fee for each license not to exceed the following:

(1) Video lottery machine manufacturer - $5,000;

(2) Video lottery machine distributor - $5,000;

(3) Video lottery machine operator - the greater of $1,000 or $100 per machine licensed; and

(4) Video lottery establishment - $100.

In addition to the annual license fees, the executive director may charge a one-time license application fee not to exceed fifty dollars. All fees collected pursuant to this section shall be deposited in the video lottery operating fund created by §42-7A-41.1. All licenses issued by the South Dakota lottery under this section are renewable annually unless sooner cancelled or terminated. No license issued under this section is transferable or assignable.

42-7A-43. *State Lottery -

Any person licensed as a video lottery machine manufacturer, distributor, operator or lottery retailer shall submit to a background investigation. This includes each partner of a partnership and each director and officer and all stockholders of five percent or more in a parent or subsidiary corporation of a video lottery machine manufacturer, distributor, operator or lottery

retailer. A video lottery machine manufacturer or distributor shall meet the same requirements of subdivisions 42-7A-13 (1) to (4) and §42-7A-14. A video lottery machine operator shall meet the same requirements of §§42-7A-13 and 42-7A-14, in addition to being a resident of the state of South Dakota and, if a partnership or corporation, the majority of ownership interest shall be held by residents of the state. A lottery retailer shall meet the same requirements of §§42-7A-13 and 42-7A-14. Any applicant for any license under this chapter has the burden of proving his qualifications to the satisfaction of the commission and executive director. The commission may adopt rules pursuant to chapter 1-26 to establish additional requirements to preserve the integrity and security of the lottery.

42-7A-63. *State Lottery - Video lottery machines - State's percentage - Deposit in general fund - Video lottery operating fund.

The commission shall maximize revenues to the state from video lottery. The state's percentage of net machine income shall be fifty percent. The state's percentage of net machine income shall be directly deposited to the property tax reduction fund, except for one-half of one percent of net machine income authorized for deposit into the video lottery operating fund. The effective date of this section is July 1, 1996.

Regulations:

48:02:02:02. Individual qualifications must be established.

No video lottery license shall be granted an applicant until the commission is satisfied that the individual qualifications of the following persons meet the requirements in SDCL 42-7A-43 and §48:02:02:01:

(1) Each person in whose name the liquor license for the on-sale consumption of alcoholic beverages is issued;

(2) Each person associated with a corporate applicant, including any corporate holding, parent, or subsidiary company of the applicant, who in the opinion of the commission has the ability to control the activities of the corporate applicant or elect a majority of the board of directors of that corporation, other than a bank or other licensed lending institution which holds a mortgage or other lien acquired in the ordinary course of business;

(3) Each of the following persons associated with a noncorporate applicant:

(a) Persons who directly or indirectly hold any beneficial interest or ownership in the applicant; or

(b) Persons who in the opinion of the commission have the ability to control the applicant;

(4) Key personnel, including any executive, employee, or agent having the power to exercise a significant

influence over decisions concerning any part of the applicant's business operation; and

(5) Employees of an operator or an establishment who are permitted access to a key for entry into a video lottery machine.

48:02:06:02. [Prior to 1996 amendment] Remittance of state's percentage of net machine income.

The state's percentage of net machine income is 35 percent. Machine owners shall remit to the lottery the state's percentage of net machine income on all their machines within the time periods required in SDCL 42-7A-45. If the 15th or last day of the month falls on a Saturday, remittance is due the preceding Friday. If the 15th or last day of the month falls on a Sunday, remittance is due the following Monday.

48:02:06:03. Remittance through electronic transfer of funds.

The state's percentage of net machine income shall be remitted to the lottery through the electronic transfer of funds. Operators shall furnish to the lottery all information and bank authorizations required to facilitate the timely payment of moneys due the state general fund. Operators must provide the lottery 30 days advance notice of any proposed account changes to ensure the uninterrupted electronic transfer of funds.